



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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November 7, 2008

Ms. Kris Perry, Executive Director
First 5 California
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

Dear Ms. Perry:

Final Report—First 5 California, 2008 Financial Statement Audit of the Children and Families Trust Fund and Related Accounts

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its financial statements audit of the First 5 California's Children and Families Trust Fund and related accounts for the fiscal year ended June 30, 2008.

The enclosed report is for your information and use. The financial statements were fairly presented in accordance with generally accepted accounting principles. Because there were no audit findings or issues requiring a response, we are issuing the report as final. In accordance with Finance's policy of increased transparency, this report will be placed on our website.

We appreciate the assistance and cooperation of First 5 California, Department of General Services, and the Board of Equalization. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Jennifer Arbis, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Diane Levin, Chief Deputy Director, First 5 California
Ms. Kim Gauthier, Chief Counsel, First 5 California
Ms. Terry L. Miller, Chief, Administrative Services Division, First 5 California
Ms. Sandra Beck, Fiscal Operations Manager, First 5 California
State Controller's Office, First 5 Oversight Unit

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First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2008

Prepared By:
Office of State Audits and Evaluations
Department of Finance

MEMBERS OF THE AUDIT TEAM:

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This report is also available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations (Finance), performed this audit in accordance with an interagency agreement between First 5 California and Finance. The objectives of our audit were to:

- Express an opinion on the *Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance* of the Children and Families Trust Fund (Fund) and related accounts for the fiscal year ended June 30, 2008.
- Verify that the financial statements were prepared in conformity with generally accepted accounting principles for governmental funds.
- As necessary, report on internal control and compliance weaknesses, and provide recommendations for improving controls over operations of the Fund and related accounts.

Audit Results

- The aforementioned financial statements are fairly presented for the fiscal year ended June 30, 2008.
- The audit did not identify any reportable internal control or compliance weaknesses.

This report is intended solely for the information and use of First 5 California and the Legislature, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

INDEPENDENT AUDITOR'S REPORT

Ms. Kris Perry, Executive Director
First 5 California
2389 Gateway Oaks Drive, Room 260
Sacramento, CA 95833

We have audited the accompanying *Balance Sheet* as of June 30, 2008, and the related *Statement of Revenues, Expenditures, and Changes in Fund Balance* of the Children and Families Trust Fund (Fund) and related accounts, for the fiscal year then ended. These financial statements are the responsibility of First 5 California's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In connection with our audit, there are certain disclosures required by *Government Auditing Standards*. The Department of Finance (Finance) is not independent of the audited entity, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund and related accounts as of June 30, 2008, and the results of operations and changes in fund balance thereof for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the First 5 California, Department of General Services, and the Board of Equalization's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of

the internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects management or the employees' ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of First 5 California's financial statements that is more than inconsequential will not be prevented or detected by the internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether First 5 California's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of First 5 California management, those charged with governance, and the Legislature, and is not intended to be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations
(916) 322-2985

November 5, 2008

BALANCE SHEET

First 5 California Children and Families Trust Fund and Related Accounts Balance Sheet At June 30, 2008

	Children and Families Trust Fund (0623)	Counties Children and Families Account (0585)	Mass Media Communications Account (0631)	Education Account (0634)	Child Care Account (0636)	Research and Development Account (0637)	Administration Account (0638)	Unallocated Account (0639)
Assets								
Cash	\$ 42,177,549	\$ 653	\$ 124,587	\$ 479,060	\$ 174,681	\$ 183,180	\$ 37,877	\$ 99,490
Deposits in SMIF	4,574,000	37,680,000	77,369,000	137,644,000	64,599,000	78,528,000	25,181,000	5,052,000
Receivables	46,424,357	0	0	0	0	0	4,182	0
Due from Other Funds ¹	1,005,814	75,475,825	6,240,641	5,810,341	3,356,659	3,456,795	1,136,059	24,801,089
Due from Other Governments	0	0	0	135,000	0	0	0	0
Prepaid Expenses	0	0	0	0	0	0	74,656	0
Total Assets	\$ 94,181,720	\$ 113,156,478	\$ 83,734,228	\$144,068,401	\$ 68,130,340	\$ 82,167,975	\$ 26,433,774	\$29,952,579
Liabilities								
Accounts Payable	\$ 0	\$ 143,071	\$ 947,989	\$ 841,479	\$ 2,431,936	\$ 334,319	\$ 85,545	\$ 2,182,388
Due to Other Funds ¹	94,175,352	0	4,112,781	9,353,247	3,929,948	6,499,696	162,443	31,029
Due to Other Governments	0	113,013,407	0	1,899,515	349,800	56,581	0	478,030
Total Liabilities	94,175,352	113,156,478	5,060,770	12,094,241	6,711,684	6,890,596	247,988	2,691,447
Fund Balance								
Reserved for Encumbrances	0	0	4,124,084	8,248,169	5,773,719	6,048,657	0	3,473,911
Reserved for Unencumbered Balances of Continuing Appropriations	6,368	0	74,549,374	123,725,991	55,644,937	69,228,722	26,185,786	23,787,221
Total Fund Balance	6,368	0	78,673,458	131,974,160	61,418,656	75,277,379	26,185,786	27,261,132
Total Liabilities and Fund Balance	\$ 94,181,720	\$ 113,156,478	\$ 83,734,228	\$144,068,401	\$ 68,130,340	\$ 82,167,975	\$ 26,433,774	\$29,952,579

¹ - See Note 2

The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE

First 5 California Children and Families Trust Fund and Related Accounts Statement of Revenues, Expenditures, and Changes in Fund Balance For the Fiscal Year Ended June 30, 2008

	Children and Families Trust Fund (0623)	Counties Children and Families Account (0585)	Mass Media Communications Account (0631)	Education Account (0634)	Child Care Account (0636)	Research and Development Account (0637)	Administration Account (0638)	Unallocated Account (0639)
Revenue								
Cigarette Tax Revenue	\$ 576,653,396	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
SMIF Interest Revenue	2,088,899	698,904	2,860,932	6,119,513	3,001,928	3,518,259	1,082,924	168,852
Other Revenue	0	0	0	1,367,576	0	0	0	0
Total Revenue	578,742,295	698,904	2,860,932	7,487,089	3,001,928	3,518,259	1,082,924	168,852
Expenditures								
Appropriation Expenditures	10,502,127	439,605,944	10,126,030	33,686,222	20,286,553	16,681,443	5,328,738	8,937,313
Excess (Deficiency) of Revenues Over(Under) Expenditures	568,240,168	(438,907,040)	(7,265,098)	(26,199,133)	(17,284,625)	(13,163,184)	(4,245,814)	(8,768,461)
Other Financing Sources & Uses								
Operating Transfers In ²	0	438,907,040	32,918,028	27,431,690	16,459,014	16,459,014	5,486,338	10,972,676
Operating Transfers Out ²	(568,233,800)	0	0	0	0	0	0	0
Net Change in Fund Balance	6,368	0	25,652,930	1,232,557	(825,611)	3,295,830	1,240,524	2,204,215
Fund Balance July 1, 2007	0	0	53,020,528	130,741,603	62,244,267	71,981,549	24,945,262	25,056,917
Fund Balance June 30, 2008	\$ 6,368	\$ 0	\$ 78,673,458	\$131,974,160	\$ 61,418,656	\$75,277,379	\$26,185,786	\$27,261,132

² - See Note 4

The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS

First 5 California Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2008

NOTE 1 Summary of Significant Accounting Policies

A. Definition of Reporting Entity

The Children and Families Trust Fund (Fund) and its related accounts were created by the California Children and Families Act of 1998 (Act). Programmatic and fiscal oversight was placed with the California Children and Families Commission (Commission). Subsequent to the Act, legislation was passed that provided for the Commission to be known as First 5 California. The Act is intended to promote, support, and improve the early development of children from the prenatal stage to five years of age. The programs authorized by this Act are administered by First 5 California and by county children and families commissions.

Effective January 1, 1999, Section 30131.2 of the Revenue and Taxation Code authorized the State Board of Equalization (Board) to collect 87 cents for each cigarette pack distributed, and a surtax on other tobacco products. Of the 87 cents collected, 50 cents is allocated and deposited into the Fund. The remainder funds the Proposition 99 and Breast Cancer programs.

While First 5 California has the full responsibility for the program and financial statements, the Board of Equalization receives, accounts for, and deposits the Cigarette Tax revenue into the Fund. Furthermore, the Department of General Services performs accounting services for First 5 California.

The Fund was established to provide funding for research and development, education, training, and other functions specified in the Act. It primarily functions as a pass-through account which transfers funds to the related accounts according to allocation percentages established by the Act. The county commissions receive 80 percent of the funding and First 5 California receives 20 percent, which is allocated to seven separate accounts which implement specific functions of the Act, as illustrated in the following table.

Allocation of Cigarette Tax Revenue

Account	Tax Revenue Allocation	Purpose
Counties Children and Families Account (0585)	80%	This account is established for 80 percent of the funds received in the California Children and Families Trust Fund (0623) to be allocated and appropriated to county commissions and expended for the purposes authorized in accordance with each county's strategic plan.
Mass Media Communications Account (0631)	6%	This account provides funding for communications to the general public utilizing television, radio, newspapers, and other mass media furthering the goals and purposes specified in the <i>California Children and Families Act of 1998</i> .
Education Account (0634)	5%	This account provides funding for education goals and purposes as specified in the <i>California Children and Families Act of 1998</i> .
Child Care Account (0636)	3%	This account provides funding for child care goals and purposes as specified in the <i>California Children and Families Act of 1998</i> .
Research and Development Account (0637)	3%	This account provides funding for research and development goals and purposes as specified in the <i>California Children and Families Act of 1998</i> .
Administration Account (0638)	1%	This account provides funding for administrative costs and other purposes as specified in the <i>California Children and Families Act of 1998</i> .
Unallocated Account (0639)	2%	This account provides funding for any other purposes of the <i>California Children and Families Act of 1998</i> , except for administrative costs.

Each county commission receives a portion of the funds equal to the percentage of the number of live births recorded in the relevant county for the most recent reporting period in proportion to the entire number of live births recorded in California for the same period. The live birth vital statistics are compiled by the Department of Public Health. All expenditures must be incurred in accordance with the provisions of the Health and Safety Code Section 130105 (d).

B. Basis of Presentation—Fund Accounting

The Fund and related accounts are classified as *Other Governmental Cost Funds* for State of California financial reporting purposes. *Other Governmental Cost Funds* are special revenue funds used to account for revenues restricted by law for specified purposes. The financial statements are presented in accordance with generally accepted accounting principles.

C. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using a current financial resources measurement focus and the modified accrual basis of accounting. This measurement focus concentrates on transactions that increase or decrease resources available for spending in the near future. Under the modified accrual basis of accounting, revenues are recorded when they become measurable and available to finance expenditures of the current period. Expenditures are recorded when the related liability is incurred.

D. Budget and Budgetary Control

The accounting policies of First 5 California conform to the State Administrative Manual (SAM) based on the State's budgetary provisions. Program funds are continuously appropriated without regard to fiscal year. First 5 California management is responsible for exercising budgetary control to ensure that appropriations are not overspent at the Fund and related accounts level. The State Controller's Office is responsible for statewide appropriation control and does not allow expenditures in excess of authorized appropriations.

E. Deposits in Surplus Money Investment Fund

Investments consist of cash in excess of current needs on deposit in the Surplus Money Investment Fund (SMIF). The Fund and related accounts participate in the State of California's Pooled Money Investment Program, whereby cash on deposit in the State Treasury determined to be in excess of immediate needs are transferred to the SMIF for investment purposes. All earnings derived from investments of the SMIF are apportioned to the contributing fund as provided in the Government Code.

F. Revenue

Revenues consist of the cigarette taxes collected on sales of cigarette packs and other tobacco products, interest income earned on funds deposited in the SMIF, refunds from reverted appropriations, and unclaimed checks escheated to the issuing fund.

G. Expenditures

Expenditures for Cycle 1 of the School Readiness Program in fiscal year 2007-2008 were \$5,556,729. Cycle 1 expenditures were allocated at the following rates: Mass Communication Account, 15 percent; Education Account, 30 percent; Child Care Account, 21 percent; Research and Development Account, 22 percent; and Unallocated Account, 12 percent.

Expenditures for Cycle 2 of the School Readiness Program in fiscal year 2007-2008 were \$42,130,067. Cycle 2 expenditures were allocated to funds at the following rates: Mass Communication Account, 18 percent; Education Account, 40 percent; Child Care Account, 17 percent; and Research and Development Account, 25 percent.

H. Compensated Absences

Liability for vested and unpaid vacation and annual leave is reported as a long-term liability on the government-wide financial statements. It is anticipated that compensated absences will generally not be used in excess of a normal year's accumulation. Unused sick leave balances are not included in compensated absences because they do not vest to employees. For further information, refer to the *State of California Comprehensive Annual Financial Report*.

I. Retirement Plan

Regular employees of First 5 California are members of the California Public Employees' Retirement System (CalPERS), which is a defined benefit contributory retirement plan. Retirement contributions by employees are set by statute as a percentage of payroll (Tier I employees), or are zero (Tier II employees). Retirement contributions are actuarially determined under a program where total contributions plus CalPERS' investment earnings will provide the necessary funds to pay retirement benefits when incurred. The employer contributions are included in the cost of personal services. For further information, refer to the *State of California Comprehensive Annual Financial Report*, and to the *CalPERS Comprehensive Annual Financial Report*.

NOTE 2 Due To/From Other Funds

The Due To Other Funds represents the cigarette tax revenues due to the other related accounts as described in Note 1. Additionally, the Due To Other Funds includes the allocations due to the Unallocated Account 0639 for the School Readiness Program administered by First 5 California. Under this Program, First 5 California distributes funds to eligible counties, in addition to the required 80 percent allocation of cigarette taxes as provided in Note 1, to assist with the development of children ages 0 through 5 to prepare them for school.

The balances of the Due To Other Funds for the Fund and related accounts are as follows:

Fund 0623:

Counties' Children and Families Account	\$ 75,340,282
Mass Media Communications Account	5,650,521
Education Account	4,708,768
Child Care Account	2,825,260
Research and Development Account	2,825,260
Administration Account	941,754
Unallocated Account	<u>1,883,507</u>
Total Due To Other Funds	<u>\$ 94,175,352</u>

Account 0631:	
Unallocated Account	<u>\$ 4,112,781</u>
Account 0634:	
General Fund	\$ 188,123
Service Revolving Fund	47,883
Unallocated Account	<u>9,117,241</u>
Total Due To Other Funds	<u>\$ 9,353,247</u>
Account 0636:	
Unallocated Account	<u>\$ 3,929,948</u>
Account 0637:	
General Fund	\$ 554,148
Unallocated Account	5,719,990
Department of Technology Services	<u>225,558</u>
Total Due To Other Funds	<u>\$ 6,499,696</u>
Account 0638:	
General Fund	\$ 37,111
State Compensation Insurance Fund	143
Service Revolving Fund	70,088
Department of Technology Services	49,307
Prison Industry Authority	3,262
Unemployment Administration Fund	<u>2,532</u>
Total Due To Other Funds	<u>\$ 162,443</u>
Account 0639:	
General Fund	<u>\$ 31,029</u>

The Due From Other Funds account represents the receivable of cigarette tax and SMIF interest revenues to the various accounts. The Unallocated Account 0639 includes receivables from the School Readiness Program. The balances of Due From Other Funds for the Fund and related accounts are as follows:

Fund 0623:	
Surplus Money Investment Fund	\$ 352,309
Cigarette Tax - Board of Equalization	<u>653,505</u>
Total Due From Other Funds	<u>\$ 1,005,814</u>
Account 0585:	
Children and Families Trust Fund	\$ 75,340,282
Surplus Money Investment Fund	<u>135,543</u>
Total Due From Other Funds	<u>\$ 75,475,825</u>

Account 0631:	
Children and Families Trust Fund	\$ 5,650,521
Surplus Money Investment Fund	<u>590,120</u>
Total Due From Other Funds	<u>\$ 6,240,641</u>
Account 0634:	
Children and Families Trust Fund	\$ 4,708,767
Surplus Money Investment Fund	<u>1,101,574</u>
Total Due From Other Funds	<u>\$ 5,810,341</u>
Account 0636:	
Children and Families Trust Fund	\$ 2,825,260
Surplus Money Investment Fund	<u>531,399</u>
Total Due From Other Funds	<u>\$ 3,356,659</u>
Account 0637:	
Children and Families Trust Fund	\$ 2,825,261
Surplus Money Investment Fund	<u>631,534</u>
Total Due From Other Funds	<u>\$ 3,456,795</u>
Account 0638:	
Children and Families Trust Fund	\$ 941,754
Surplus Money Investment Fund	<u>194,305</u>
Total Due From Other Funds	<u>\$ 1,136,059</u>
Account 0639:	
Children and Families Trust Fund	\$ 1,883,507
Mass Media Communications Account	4,112,781
Education Account	9,117,241
Child Care Account	3,929,949
Research and Development Account	5,719,990
Surplus Money Investment Fund	<u>37,621</u>
Total Due From Other Funds	<u>\$24,801,089</u>

NOTE 3 Fund Balance

The term *fund balance* is defined as the excess of the assets of a fund over its liabilities. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balance that are legally segregated for specific uses.

Reserved for Encumbrances represents goods and services that are ordered, but not received, by the end of the fiscal year.

Reserved for Unencumbered Balances of Continuing Appropriations represents the unencumbered balances of all appropriations for which the period of availability extends beyond the period covered by this report. These appropriations are legally segregated for a specific future use.

NOTE 4 Operating Transfers

Legally authorized transfers between state funds are reported on the *Statement of Revenues, Expenditures, and Changes in Fund Balance* as Operating Transfers In or Operating Transfers Out, and are accounted for as increases or decreases in residual equity.

Operating Transfers Out represents the sum of the Operating Transfers In and the statutorily required backfill of \$19,600,000 for the Proposition 99 and Breast Cancer programs. The Operating Transfers In are calculated based on the applicable percentage of the Fund revenues, which include cigarette taxes and SMIF interest income. Balances are derived as follows:

Cigarette Tax Revenue	\$ 576,653,396
SMIF Interest Revenue	2,088,899
Board of Equalization State Operations	<u>(10,508,495)</u>
Total Operating Transfers Out	568,233,800
Backfill	<u>(19,600,000)</u>
Total Operating Transfers In	<u>\$ 548,633,800</u>

The Health and Safety Code Section 130105 requires the backfill of lost funding for certain Proposition 99 and Breast Cancer Fund programs. Specifically, the Code provides that the State Board of Equalization shall determine within one year of the passage of this act the effect that additional taxes imposed on cigarettes and tobacco products by this act has on the consumption of cigarettes and tobacco products in this state. To the extent that a decrease in consumption is determined by the State Board of Equalization to be the direct result of additional taxes imposed by this act, the State Board of Equalization shall determine the fiscal effect the decrease in consumption has on the funding of any Proposition 99 (the Tobacco Tax and Health Protection Act of 1988) state health-related education or research programs in effect as of November 1, 1998, and the Breast Cancer Fund programs that are funded by excise taxes on cigarettes and tobacco products. Funds shall be transferred from the California Children and Families Trust Fund to those affected programs as necessary to offset the revenue decrease directly resulting from the imposition of additional taxes by this act. Such reimbursements shall occur, and at such times, as determined necessary to further the intent of this subdivision.